Ceres Accelerator
for Sustainable Capital Markets

February 16, 2024

Via Public Comment Portal

Christopher Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street NW
Washington, DC 20581

Re: Commission Guidance Regarding the Listing of Voluntary Carbon Credit Derivative Contracts; Request for Comment (88 FR 89410, December 27, 2023)

Dear Mr. Kirkpatrick,

We respectfully submit this letter in response to the Request for Comment on Commission Guidance Regarding the Listing of Voluntary Carbon Credit Derivative Contracts, published by the Commodity Futures Trading Commission ("CFTC" or "Commission") on December 27, 2023.

Introduction

It is a pleasure to submit this response on behalf of Ceres and the Ceres Accelerator for Sustainable Capital Markets. Ceres is a nonprofit organization working with influential leaders to solve the world's greatest sustainability challenges. Through our powerful networks and global collaborations of investors, companies, and nonprofits, we drive action and inspire equitable market-based and policy solutions throughout the economy to build a just and sustainable future.

The Accelerator for Sustainable Capital Markets is a center of excellence within Ceres that aims to transform the practices and policies that govern capital markets to reduce the worst financial impacts of the climate crisis. Ceres' Investor Network currently includes more than 220 institutional investors that collectively manage approximately $45 trillion in assets. These investors are concerned about the impact of climate change on financial markets and the economy. Our Company Network includes more than 50 of the largest global companies with whom we work on climate strategy and disclosure, among other issues. The Ceres Policy Network, known as BICEP, comprises more than 85 companies, including dozens of leading consumer brands and Fortune 500 companies, advocating for strong climate, clean energy, and water policies at the state and federal levels. The comments provided herein represent only the opinions of Ceres, and do not necessarily infer endorsement by each member of our Investor, Company, or Policy networks.

We applaud the CFTC for this proposed guidance. This is an important step and one that we recommended in our 2023 Climate Risk Scorecard. We believe this guidance will help ensure that designated contract markets ("DCMs") take measures to verify the quality of voluntary carbon credits ("VCCs") underlying the derivative contracts that DCMs list for trading. This guidance is a prudent step within the CFTC's statutory authority to promote accurate pricing of carbon credit derivatives and reduce the susceptibility of voluntary carbon markets ("VCMs") and VCM-based derivatives to manipulation. By providing much needed oversight and introducing more rigorous evaluation of credits' integrity, we believe the CFTC's guidance will hasten the development of more robust VCM-based derivatives by driving more accurate price discovery, increasing liquidity, and limiting manipulation.

Ceres primarily focuses on the demand side of VCMs: encouraging companies with net-zero targets to only use credits in a way that supports the global goal of limiting warming to 1.5°C. While different IPCC net-zero scenarios place different levels of reliance on carbon removals, all scenarios imply deep emission reductions in all economic sectors. This necessitates that companies with net-zero goals prioritize reducing their value chain emissions, while any remaining residual emissions that are infeasible to abate must be neutralized with carbon removals. While on the journey to net zero, companies are also encouraged to go above and beyond their goals and finance additional emission reductions and carbon removals, including by purchasing carbon credits. Such action can make a critical contribution to limiting global climate change when it is carried out in addition to—not instead of—ambitious emission reductions in line with 1.5ºC.

The greatest threats to VCMs stem from concerns about the integrity of carbon offsets, the projects and developers that create them, and the organizations that verify and register them. There is a significant risk that the claimed benefits of carbon offsets will not materialize, whether deliberately or through misconduct, which in turn creates fundamental risk for the entire market. That is why, in our October 2022 response to the Commission's Climate-Related Financial Risk RFI, we encouraged the CFTC "to pursue its authority to oversee derivatives with offsets as underlying" and "play an important role in setting appropriate standards for carbon offsets, thereby increasing confidence in that market, and ultimately encouraging the flow of risk capital into the market for climate solutions." We are pleased to see the Commission exercising its authority in this relatively nascent market and encouraging adherence to critical principles such as transparency, additionality, and permanence. The novelty of this derivatives market calls for increased regulatory scrutiny, and the Commission's guidance will help reduce greenwashing, bolster confidence in domestic carbon markets, and make it easier for market participants to identify high-quality carbon credits underlying VCC derivative contracts.

The Commission has worked to align this guidance with the Integrity Council for the Voluntary Carbon Market ("ICVCM"). We agree that alignment is necessary to avoid creating duplicative standards for crediting programs and multiple classes of credit integrity, which would have the potential to add confusion to the market. We recommend that the Commission clarify that DCMs should rely on crediting programs to demonstrate they have the processes and procedures in

place to ensure high-integrity underlying credits rather than conducting additional due diligence. Carbon-crediting programs with a 98% share of the market have already applied to use the Core Carbon Principles label and are being assessed by ICVCM. Due diligence requirements for DCMs in addition to reliance on ICVCM could create duplicative standards for crediting programs, projects, and their VCCs. In our comments below, we highlight where the Commission can aim for more alignment with ICVCM.

This guidance covers a broad range of important questions; we will address these questions selectively where we feel our input may be most useful to the Commission.

Summary of Recommendations

1. **Transparency**: We support the Commission's recommendation that DCMs provide, in a contract's terms and conditions, information about the VCCs eligible for delivery under the contract, including specific information on crediting programs.
2. **Additionality**: DCMs should consider a range of approaches for testing additionality. While we believe additionality is a key characteristic of an authentic carbon credit, we do not believe that financial additionality should be the only measure of additionality.
3. **Risk of Reversal**: We agree with the buffer pool approach to mitigating reversal risk.
4. **Robust Quantification**: We agree that accuracy in quantification is critical to a robust VCM-based derivatives market. We caution against overly focusing on conservative accounting and recommend that DCMs appropriately use conservativeness in service of the goal of accuracy.
5. **Sustainable Development Benefits and Safeguards**: We recommend that a DCM should consider whether a crediting program has measures in place to ensure that projects meet or exceed best practices on social and environmental safeguards, because those are elements affecting the accuracy of pricing.

Transparency (Question 6)

Ceres agrees that a DCM should provide information in a contract's terms and conditions about the VCCs eligible for delivery under the contract. We agree that DCMs should specifically identify the crediting program or programs from which VCCs may be issued. DCMs should establish criteria for crediting programs and only consider crediting programs that have registries with a wide variety of publicly available project information (including project type, methodology, project description documents, validation reports, monitoring reports, and verification reports, among others).

Additionality (Questions 7, 8)

Ceres agrees that additionality is a key requirement for eligible VCC derivatives. The Commission asks if financial additionality is the appropriate way to characterize additionality for this guidance, or if another characterization may be more appropriate. Ceres believes that DCMs should consider a range of approaches for testing additionality. We do not believe that financial additionality (investment analysis) should be the only measure of additionality.

Traditionally, projects have been considered additional only if revenue from selling carbon credits would make the activity financially viable. Financial additionality can be a reasonable test for technological project types, but it is not usually the best test for natural climate solutions ("NCS") project types. NCS are activities that protect, restore, or improve the management of nature and mitigate climate change by reducing greenhouse gas emissions or removing carbon from the atmosphere. Examples of NCS projects include the protection of forests, wetlands, or grasslands; better management of grasslands, grazing lands, or timber lands; and restoration of forests and wetlands. For these types of projects, it can be a burden on small landowners to gather the data necessary to demonstrate financial additionality. While some corporations may make decisions based solely on financial factors, many farmers and other landowners operate without access to perfect or complete information, which means they do not make decisions solely based on finances. Efforts to end deforestation, improve land management, and restore land are in need of significant financing, and it is important not to design VCM incentives that inadvertently place higher, or often impossible, burdens on NCS projects.

Ceres recommends the CFTC also recognize barrier analysis, market penetration rates, positive lists (i.e., registers of qualifying abatement activities that are eligible to earn carbon credits), and performance standard approaches. More information on these approaches is provided in the ICVCM Core Carbon Principles Assessment Framework.

We also think that, in some instances, being required by law does not preclude a carbon-reducing activity to be potentially eligible for use as an underlying source of credit. For jurisdictions in which activities are required by law and that law is rigorously enforced, those activities should *not* be considered additional. However, we note that in some jurisdictions laws are not always well enforced, and in these situations, a regulatory requirement is not a good basis for negating additionality. For example, projects that avoid deforestation are sometimes based in areas where deforestation is occurring illegally. That is, avoiding deforestation is the legal requirement, yet deforestation continues to happen. Projects that address illegal deforestation in those circumstances should still be eligible for the additionality consideration. Please refer to the ICVCM Assessment Framework for more details.

Risk of Reversal (Question 9)

As the Commission notes in its guidance, most crediting programs set aside VCCs into a common buffer reserve, or "pool," to address reversal risk. Ceres agrees with the buffer pool approach to mitigating instances when a reversal occurs. The buffer pool approach not only serves as a compensation mechanism, but also incentivizes projects to set long-term commitments (i.e., projects and programs that can earn a lower risk rating). In the case of NCS project types, the approach also provides an incentive to landowners to maintain projects and either maintain or lower the risk of reversal.

Robust Quantification (Question 11)

Ceres agrees that robust quantification and accurate accounting are important. However, we caution against overly focusing on conservative accounting and recommend that DCMs

appropriately balance requirements for conservativeness with the ultimate goal of accuracy. Focusing on choosing conservative parameters can lead to an underestimation of emission reductions or removals and can undermine meaningful reductions and removals, as well as undermining progress towards improved monitoring and data collection. If estimates are more accurate, projects should not always be forced to make the most conservative estimations. Quantification methodologies should strive to be as accurate as possible, and conservativeness can serve as a tool for promoting accuracy in the face of uncertainty, to ensure that projects are not overestimating emission reductions or removals.

In order to consider whether the crediting program for the underlying VCCs can demonstrate that the quantification methodology or protocol is robust, conservative, and transparent, we recommend that the Commission align with the ICVCM on robust quantification. The ICVCM is currently reviewing and identifying methodologies for adherence to the high-integrity Core Carbon Principles. The process involves multi-stakeholder working groups, including expert panel members and external experts with relevant knowledge. DCMs should be able to rely on the outcomes of the ICVCM and do not need to conduct additional due diligence. And, DCMs can rely on crediting programs to demonstrate they have the processes and procedures in place to achieve high-integrity credits.

Sustainable Development Benefits and Safeguards (Questions 16, 17)
Ceres recommends that a DCM should consider whether a crediting program has measures in place to ensure that projects meet or exceed best practices on social and environmental safeguards. Safeguards help strengthen participation, improve the distribution of benefits and burdens, and enhance cultural and political recognition. With safeguards in place, carbon projects are more likely to be sustained and meaningfully contribute to emission reductions and carbon sequestration over time, thus reducing the risk to credit buyers and enhancing the accuracy of derivative products' pricing. In Ceres' March 2022 report, *Evaluating the Use of Carbon Credits*, we recommend safeguards that relate to:

- Upholding the rights of Indigenous Peoples and local communities;
- Land tenure and access;
- Full and effective community participation;
- Grievance and redress mechanisms;
- Generating benefits;
- Benefit-sharing mechanisms;
- Protecting biodiversity and critical ecosystems; and
- Implementing ecosystem-appropriate practices.

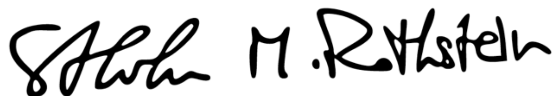
In addition to Ceres' report, we recommend drawing from existing safeguards standards, including the Cancun Safeguards and Climate, Community, and Biodiversity Standards.

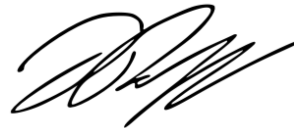
It is important to note that safeguard requirements are relatively new and carbon credits that were issued in the past may not adhere to safeguard requirements. DCMs should consider how to

phase in safeguard requirements for newer vintages or to differentiate between VCCs with additional safeguard requirements and those without.

We thank the Commission for its leadership on this critical issue and are happy to discuss any questions you may have about our feedback. Please contact Jake Rascoff (jrascoff@ceres.org) at your convenience.

Respectfully submitted,





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